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Supreme Court Ruling Enforces Arbitration Agreements That Preclude Class Action Procedures

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The United States Supreme Court's decision in *AT&T Mobility LLC v. Concepcion,* No. 09-893, 563 U.S. ___ (April 27, 2011) is a potential game changer for companies doing business in California (and, indeed, throughout the country). California courts had refused to enforce certain arbitration agreements unless they permitted arbitration on a classwide basis. The Supreme Court yesterday put an end to that practice, holding that California (and other state) laws to that effect are preempted by the Federal Arbitration Act ("FAA"), and that courts must enforce agreements to arbitrate on an individual basis. O'Melveny & Myers filed an amicus brief in the case on behalf of the Center for Class Action Fairness, advocating for the position that was ultimately adopted by the Supreme Court.

Following *AT&T Mobility,* many consumer and employment class actions may be avoidable by utilizing agreements that require arbitration, but prohibit the use of class action procedures. When an individual subject to such an agreement files a putative class action in court, the company should be able to compel arbitration of his or her claims on an individual basis, and the class claims should be aborted *ab initio.* Given the extraordinary expense and burden to companies of defending against class actions, not to mention the danger of *in terrorem* settlements, the Supreme Court's decision in *AT&T Mobility* provides a significant incentive for companies to consider revising their existing arbitration agreements or implementing new ones.

The decision. In *AT&T Mobility,* the plaintiff entered into a contract that provided for arbitration of all disputes between the parties, but required that claims be brought in the parties' "individual capacity, and not as a plaintiff or class member in any purported class or representative proceeding." Slip. op. at 1. The plaintiff sued, and the defendant moved to compel arbitration under the agreement. The district court denied the motion to compel, relying on the California Supreme Court's decision in *Discover Bank v. Superior Court,* 36 Cal. 4th 148 (2005). Under "the *Discover Bank* rule," California courts had declared most collective-arbitration waivers in consumer contracts to be unconscionable or otherwise unenforceable.

The Supreme Court addressed the question whether the *Discover Bank* rule was preempted by the FAA. Section 2 of the FAA "permits arbitration agreements to be declared unenforceable 'upon such grounds as exist at law or in equity for the revocation of any contract.'" Slip. op. at 5. The plaintiff alternatively argued that (1) the *Discover Bank* rule had "its origins in California's unconscionability doctrine," which is an existing ground for revocation of a contract; or (2) "even if we construe the *Discover Bank* rule as a prohibition on collective-action waivers rather than simply an application of unconscionability, the rule would still be applicable to all dispute-resolution contracts, since California prohibits waivers of class litigation as well." Slip. op. at 6. The Supreme Court rejected both arguments. As a result, individuals can no longer claim that an arbitration agreement's preclusion of classwide arbitration renders the agreement either unconscionable or otherwise unenforceable.

As the Supreme Court explained, "the overarching purpose of the FAA . . . is to ensure the enforcement of arbitration agreements according to their terms so as to facilitate streamlined proceedings. Requiring the availability of classwide arbitration interferes with fundamental attributes of arbitration and thus creates a scheme inconsistent with the FAA." Slip. op. at 9. In particular, arbitration fundamentally is supposed to be a quicker and less formal alternative to litigation. But classwide arbitration is neither quick nor informal. The very notion of "classwide arbitration," therefore, is an oxymoron. Because class action procedures are incompatible with the arbitration mechanism itself, the Supreme Court held it necessarily follows that states may not require classwide arbitration—and may not require that parties agree to classwide arbitration as a condition of enforcing arbitration agreements. The Supreme Court rested that holding on three prongs:

"First, the switch from bilateral to class arbitration sacrifices the principal advantage of arbitration—its informality—and makes the process slower, more costly, and more likely to generate procedural morass than final judgment." Slip. op. at 14. The Supreme Court noted that individual arbitrations generally take four to six months. By contrast, class arbitrations generally take close to two years to reach any kind of resolution (dismissal, settlement, or the like)—and the Supreme Court could not find a single

classwide arbitration that was ever resolved through a judgment on the merits. From a practical standpoint, the Supreme Court found that classwide arbitration was a failure.

"Second, class arbitration requires procedural formality." Slip. op. at 15. The Supreme Court noted that one of the primary benefits of arbitration is its informality. But class actions—whether in court or in arbitration—cannot proceed without observing formal procedures because, in the absence of such formality, absent class members would not be bound by the judgment. "And it is at the very least odd to think that an arbitrator would be entrusted with ensuring that third parties' due process rights are satisfied." *Id.*

"Third, class arbitration greatly increases risks to defendants." Slip. op. at 15. The Supreme Court explained: "Informal procedures do of course have a cost: The absence of multilayered review makes it more likely that errors will go uncorrected. Defendants are willing to accept the costs of these errors in arbitration, since their impact is limited to the size of individual disputes, and presumably outweighed by savings from avoiding the courts. But when damages allegedly owed to tens of thousands of potential claimants are aggregated and decided at once, the risk of an error will often become unacceptable. Faced with even a small chance of a devastating loss, defendants will be pressured into settling questionable claims." Slip. op. at 15-16.

The Supreme Court concluded, therefore, that "[a]rbitration is poorly suited to the higher stakes of class litigation." Slip. op. at 16. The Court also rejected the dissent's view – which echoed the plaintiffs' arguments – that the *Discover Bank* rule was "necessary to prosecute small dollar claims that might otherwise slip through the legal system." Slip. op. at 17. Thus, the Court held that, "[b]ecause it 'stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress,' California's *Discover Bank* rule is preempted by the FAA." Slip. op. at 18 (quoting *Hines v. Davidowitz,* 312 U.S. 52, 67 (1941)).

The implications. The immediate effect of *AT&T Mobility* is that companies with existing arbitration provisions that preclude classwide arbitration should be more successful in compelling arbitration on an individual basis. *AT&T Mobility* should be recognized as a decision that addresses, at its core, the enforceability of such arbitration agreements – not a decision about class actions *per se.*

The longer-term effect of *AT&T Mobility,* however, may be much more profound—it could significantly limit companies' exposure to class actions in any form or forum.

If a company has an agreement with an individual to arbitrate his or her claims on an individual basis, that individual should be unable to serve as a class representative in a judicial action. Where that disgruntled individual is

the impetus for a putative class action against the company, the arbitrability of his or her claims should stop the class action in its tracks.

If a company has agreements with a significant number of putative class members to arbitrate their claims on an individual basis, plaintiffs' counsel not only may have difficulty in finding a suitable class representative but may also find that the exclusion of individuals with arbitration agreements as class members severely curtails the company's exposure to class action claims.

If a company has an agreement with all of the putative class members to arbitrate their claims on an individual basis, there may be no one left to bring a class action claim.

The benefits of having arbitration agreements are much more compelling after *AT&T Mobility.* The decision whether to implement such agreements is no longer limited to the costs and benefits of arbitration itself. Companies can and should also consider the costs of defending against class actions in court and the benefits of converting those actions into arbitrations regarding individual claims. Even companies that might otherwise prefer to have all disputes resolved in court may now decide that potential insulation from class actions is worth diverting those disputes to arbitration. Of course, companies should also continue to consider the negative aspects of arbitration—such as the lack of dispositive motion practice and the extremely limited ability to seek appellate review—as these aspects apply to each company's unique situation.

Nonetheless, the breadth of class claims that companies may be able to avoid under *AT&T Mobility* is worth discussing. That case arose in the consumer context, and companies that provide goods or services to consumers can use it to prevent consumers from pursuing class actions by requiring arbitration on an individual basis. But the decision is also significant in the employment context, where California courts also had a storied history of refusing to enforce arbitration agreements. By including appropriate arbitration provisions in its employment agreements, an employer may be able to avoid class action claims for violation of wage and hour laws, anti-discrimination laws, and other employment law claims.

The time to consider revising or implementing an arbitration policy is now. Because courts previously found arbitration provisions unconscionable if they precluded classwide arbitration in most instances, many companies did not include such provisions. In light of this dramatic change in the law, companies should give consideration to modifying these existing policies.

Companies should also keep abreast of the further developments that are inevitable following a ground-moving decision such as this. *AT&T Mobility* could prompt a legislative response. Indeed, in a press release posted on Senator Al Franken's (D-Minn.) official website, the following statement

was made on the day of the AT&T decision:

“After consumers were dealt a blow today when the Supreme Court ruled that companies can ban class action suits in contracts, U.S. Sens. Al Franken (D-Minn.) and Richard Blumenthal (D- Conn.) and Rep. Hank Johnson (D-Ga.) said today they plan to introduce legislation next week that would restore consumers' rights to seek justice in the courts. Their bill, called the Arbitration Fairness Act, would eliminate forced arbitration clauses in employment, consumer, and civil rights cases, and would allow consumers and workers to choose arbitration after a dispute occurred.”

Companies should consider the potential impact of such amendments when drafting their policies.

Companies should also consider the likely arguments that the plaintiffs’ bar will employ to avoid the effects of *AT&T Mobility.* The Supreme Court has held that courts cannot refuse to enforce arbitration provisions based on their preclusion of class action procedures. But courts can still refuse to enforce arbitration provisions for other reasons. Plaintiffs’ lawyers will not hesitate to use the latter to circumvent the former. If they can successfully argue, for example, that an arbitration provision is unconscionable or unenforceable on other grounds, the result may be that courts will refuse to compel arbitration at all—and therefore allow class action claims to proceed in court.

In this vein, it is worth noting that *AT&T Mobility* is not the first pro-arbitration decision from the Supreme Court, nor is it even the first pro-arbitration decision that has reversed a Ninth Circuit ruling grounded in the very anti-arbitration sentiment that the Federal Arbitration Act was enacted to overcome. Historically, such pronouncements have not stopped the Ninth Circuit or the California courts from trying to find new ways around Federal Arbitration Act. Thus, there will be no shortage of arguments by Plaintiffs’ counsel that arbitration agreements are unenforceable for other reasons.

In short, to obtain the benefits of *AT&T Mobility,* companies must draft arbitration agreements that preclude class claims and are otherwise enforceable. Thus, in considering whether to implement any changes in the wake of *AT&T Mobility,* companies should consult with counsel experienced in drafting arbitration provisions and litigating their enforceability.